



HONG KONG MONETARY AUTHORITY

香港金融管理局

Our Ref: B1/15C
B9/195C

25 May 2022

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Final Report on Focused Review on Incentive Systems of Front Offices in Retail Banks

I am writing to share the observations gleaned from, as well as incentive design principles and sound industry practices identified in, the Focused Review on Incentive Systems of Front Offices in Retail Banks in their sale and distribution of banking, investment and insurance products (“Focused Review”).

Background

As part of the ongoing effort of the HKMA since the launch of the Bank Culture Reform in promoting sound culture in the banking sector in 2017, the Focused Review commencing in 2021 is a major industry-wide culture exercise covering 20 retail banks, aiming to achieve better alignment of incentive systems of frontline staff with customers’ interests.

Building on the interim insights of the Focused Review shared with the industry in November 2021¹, the HKMA, with the support of an external consultant, has recently completed the entire review. Insights have been drawn from a comprehensive set of information gathered from a wide range of activities, including the first-ever industry-wide employee survey encompassing all frontline staff of the participating retail banks, focus group discussions, individual interviews, as well as document reviews, in order to gauge perceptions of the frontline staff of the retail banks on their banks’ incentive systems, culture, as well as customer and conduct outcomes.

¹ HKMA Circular on “Interim Report on Focused Review on Incentive Systems of Front Offices in Retail Banks” issued on 23 November 2021.

Review Observations

The Focused Review highlights four major observations in relation to the way incentive systems of front offices drive frontline behaviour and customer outcomes:

- (a) **Understanding customer outcomes** – Incentive systems may not fully reflect good customer outcomes, which are often interpreted by frontline staff as “customer satisfaction”. If staff are measured on metrics with main focus on “customer satisfaction”, the incentive systems may not necessarily drive the desired staff behaviour for achieving good customer outcomes;
- (b) **Aligning staff behaviour** – Some common incentive practices (e.g. rewarding financial performance more than non-financial performance, exerting excessive pressure to meet business targets through day-to-day interactions and socially-based recognition) may unintentionally push staff to prioritise business objectives over customer outcomes, and undermine the customer-centric culture that banks are seeking to build;
- (c) **Motivating frontline staff** – Incentive systems generally emphasise financial incentives, but in fact, other types of rewards such as those reflected in intrinsic values of staff may also be effective in motivating good customer outcomes. There is room for more and better use of rewards related to non-financial performance; and
- (d) **Effectiveness of incentive systems** – Some factors (including transparency and consistency of incentives for non-financial performance) may impact the effectiveness of incentives in reinforcing a focus on good customer outcomes.

Incentive Design Principles and Practices

Riding on the above key observations, the Focused Review has identified six incentive design principles to reinforce good customer and conduct outcomes, taking into account the context of individual banks. These include:

- (a) **clear prioritisation of customer outcomes** – to avoid staff struggling with competing goals;

- (b) **development of an aligned system** – to ensure consistency with other mutually reinforcing components within the overall culture of the bank;
- (c) **focusing on intrinsic motivators** – to rely more on robust non-financial incentives, which are more effective and with less risk and cost to banks;
- (d) **wise use of technology** – to embrace Fintech and adopt more advanced technologies (such as Artificial Intelligence and Machine Learning) to help detect undesirable behaviours and monitor misconduct more efficiently and effectively;
- (e) **close connection between leaders and staff** – to foster stronger alignment at various levels with a view to improving the impact of incentives by increasing opportunities for robust oversight, feedback and assessment, especially on non-financial performance; and
- (f) **minimising potential misconduct and mis-selling behaviours** – to carefully design the incentive systems to induce sound behaviour of staff and minimise any potential misconduct and mis-selling activities.

The review has also identified 17 sound practices implemented by banks that reflect the above six principles and help address the common challenges in relation to incentive systems of front offices. Details are provided in the attached Final Report (see Annex).

Next Steps

Culture is set and owned by banks underpinned by appropriate incentive systems that induce desired behaviours at all levels. The Focused Review, as an industry-wide exercise to look into incentive systems, aims to provide meaningful and valuable inputs to banks for their continuous culture enhancement efforts. The HKMA will not take supervisory actions against individual participating banks based on the findings of the Focused Review. Moreover, the incentive design principles and sound industry practices identified in the review are not intended for strict compliance by banks as regulatory requirements. Authorized Institutions (“AIs”) are encouraged to make reference to the observations identified in the Focused Review, and consider the six incentive design principles and sound industry practices when

designing their own incentive systems, taking into account their positioning in the industry as well as their desired culture, values, and behavioural standards. AIs are also encouraged to continue their culture efforts in tandem with their initiatives on incentive systems in reinforcing good customer and conduct outcomes.

Should you have any questions about this circular, please do not hesitate to contact Ms Christine Wong or Ms Yoyo Wong at bankculture@hkma.iclnet.hk.

Yours faithfully,

Arthur Yuen
Deputy Chief Executive

Encl.